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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 1086

FIRST NATIONAL BANK IN HOUSTON, ET AL., *Petitioners*,

v.

FRANK SCOFIELD, COLLECTOR OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Fifth Circuit

AND BRIEF IN SUPPORT THEREOF

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PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Fifth Circuit

To the Honorable Supreme Court of the United States:

The Petitioner, First National Bank in Houston, respectfully presents this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

Summary Statement of Matter Involved

This action at law was brought in the District Court of the United States for the Southern District of Texas, Houston Division, by The First National Bank of Houston, Houston, Texas, and its successor, First National Bank in Houston, Petitioners herein, against Frank Scofield, Collector of Internal Revenue, Respondent herein. The succession has no

bearing on the issues in the case. Accordingly, First National Bank in Houston alone will be deemed the Petitioner.

The action was brought to recover additional or deficiency income taxes that were paid under protest by Petitioner for the taxable year of 1937. The case was tried by the Court without a jury. Judgment was rendered in favor of Petitioner against Respondent for the amount of $24,435.41, together with interest thereon from September 14, 1940 at the legal rate. On appeal, the United States Circuit Court of Appeals for the Fifth Circuit reversed the *fact findings* and judgment of the District Court and rendered judgment for Respondent. The Circuit Court rested its judgment of reversal on the ground that the loss in question was sustained and should have been ascertained by Petitioner prior to 1937. There is no question as to the deductibility of the loss; *the sole question for determination is whether the Circuit Court of Appeals erred in reversing the fact finding of the District Court that the loss was both sustained and ascertained by Petitioner in 1937.*

The evidence was in part stipulated and in part offered by witnesses. In 1931 the Public National Bank & Trust Company of Houston was in imminent danger of failure. Petitioner and other banks and certain business concerns, "believing that the closing of the Public National Bank & Trust Company would have a disadvantageous and perhaps disastrous effect upon their own businesses, undertook to work out a plan which would enable the Public National Bank & Trust Company to remain open. The plan agreed upon was that The National Bank of Commerce of Houston would undertake the orderly liquidation of the Public National Bank & Trust Company, as liquidating agent, assuming all of its liabilities and taking over all of its assets, except stockholders' liability, provided a guaranty fund of $1,200,000.00 was raised to protect the liquidating agent against loss."

Thereupon, those interested made subscriptions to this guaranty or indemnity fund in varying amounts. Petitioner subscribed and paid $150,000.00 (R. p. 14).

On October 26, 1931, the Public National Bank & Trust Company entered into a contract with The National Bank of Commerce (R. pp. 20-30) whereby Public National transferred all of its assets and the accounts of depositors to The National Bank of Commerce, except stockholders' liability, and The National Bank of Commerce assumed all of its liabilities. *Public National was thus in effect merged into The National Bank of Commerce.*

Petitioner entered into a contract with National Bank of Commerce on October 27, 1931 (R. pp. 31-33), wherein Petitioner agreed to pay to that bank the sum of $150,000.00 as its part of the indemnity fund of $1,200,000.00 in consideration of the execution of the above mentioned contract by National Bank of Commerce with Public National. Pursuant to its contract and simultaneously therewith, Petitioner paid the $150,000.00 to National Bank of Commerce. The item was entered in Petitioner's profit and loss account because of the exacting attitude of the bank examiners with reference to items that were at all doubtful (R. p. 70). However, when Petitioner entered into its contract with National Bank of Commerce, it was furnished a statement of assets and liabilities of Public National, which showed the latter had assets, exclusive of stockholders' liability, *considerably in excess of liabilities* (R. p. 36). Petitioner's contract further provided that its $150,000.00 payment to the indemnity fund *would be repaid*, either in full or pro rata, if the results of the liquidation of Public National permitted (R. p. 33). Accordingly, Petitioner carried the indemnity item as an asset on its income tax returns until 1937 when the final report of National Bank of Commerce, as liquidator, revealed the item was a loss (R. pp. 71, 115, 118-119).

Petitioner's contract with National Bank of Commerce, hereinafter termed liquidator, *did not grant it any right to inquire* of the liquidator as to the status and progress of the liquidation of Public National (R. pp. 31-33). No one other than the liquidator had any dependable information in that regard.

Only one of the fifteen subscribers to the indemnity fund inquired at any time of the liquidator as to the progress of the liquidation (R. p. 90). The party who sought this information *was not acting "even informally * * * as a representative of other banks"* (R. p. 91). Some of the contributors deducted their loss in their income tax returns prior to 1937, but the District Court found in this connection that they simply did *"some long range guessing"* (R. p. 144). Petitioner made no inquiry as to the status or progress of the liquidation; *it had "implicit confidence" in the ability and integrity of the liquidator* (R. p. 84). The contract did not limit the time allowed for liquidation and provided that a final report and settlement with Petitioner would be made only *"when the liquidation is fully completed"* (R. p. 33). The liquidator did not make its final report of the liquidation *until November 8, 1937.*

Petitioner received only one report from the liquidator prior to the final report and that was a balance sheet of Public National as of October 26, 1932, *one year after the liquidation began,* which showed that *its assets exceeded its liabilities by the amount of $764,907.05* (R. pp. 38-39, 82-83, 84-85). Notwithstanding, the final report of November 8, 1937 showed that the liquidator had sustained a loss in the liquidation of such amount that Petitioner would not be repaid any part of the $150,000.00 it paid into the indemnity fund. Petitioner thereupon charged off the item in its 1937 income tax return. There is no evidence of any character that Petitioner had any knowledge whatever that the item

was a loss prior to 1937, if this was a fact, which Petitioner denies.

At the instance of the liquidator, a receiver was appointed for Public National on December 13, 1932. The United States Comptroller of the Currency, on February 1, 1933, made assessments against the stockholders for the full amount of their stockholders' statutory liability in the amount of $800,000.00. The receiver collected assessments and made payments to the liquidator of $106,785.47 on April 2, 1934, $30,510.13 on December 5, 1934, and $9,021.74 on October 14, 1937. A further and final credit for unpaid assessments was made by the liquidator on September 14, 1937. Judgments against stockholders were being obtained and entered in 1933, 1934, 1935, 1936, and the receiver did not file his petition to wind up the affairs of Public National until August 12, 1937 (R. pp. 16-18). The liquidator, testifying for Respondent, said he did not consider the liquidation "had been completed" until November 8, 1937, when he filed his final report (R. p. 97).

The Commissioner of Internal Revenue disallowed the deduction taken by Petitioner in 1937 and in August 1940 assessed an additional or deficiency income tax against Petitioner for 1937 in the amount of $21,316.49, together with interest thereon in the amount of $3,118.92, or a total of $24,435.41, which Petitioner paid under protest September 14, 1940. Petitioner, on July 18, 1942, filed its claim for a refund of the payment and the claim was disallowed February 9, 1944 (R. pp. 19-20). This suit to recover the payment followed.

Jurisdictional Statement

This Honorable Court has jurisdiction of this case for the following reasons:

(1) A Federal question of general interest and importance is here presented *as to when a loss is deductible for income tax purposes and as to the jurisdiction of a Circuit Court of Appeals to reverse the finding of a District Court in that regard.*

(2) The Circuit Court of Appeals for the Ninth Circuit has held, *and it is uniformly held*, that the question as to the year in which a loss occurs and is therefore deductible for income tax purposes is *purely a question of fact.* JONES v. COMMISSIONER OF INTERNAL REVENUE, 103 F. (2d) 681. And this Honorable Court has held that a Circuit Court of Appeals has no jurisdiction to reverse a fact finding of a District Court that is supported by *any substantial evidence.* DOOLEY v. PEASE, 45 L. Ed. 457. The fact finding of the District Court that the loss occurred in 1937 is supported not only by some substantial evidence but by a *great preponderance of the evidence.* Some of this evidence is reflected in the opinion of the Circuit Court of Appeals; much of it appears in the opinion of the District Court. *The Circuit Court erroneously treated and referred to this fact finding as a "conclusion of law"* that could be overruled if considered to be *merely against the weight of the evidence.* The source and nature of the error committed by that Court was thus clearly revealed. *For these reasons, the decision of the Circuit Court of Appeals herein is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in* JONES v. COMMISSIONER OF INTERNAL REVENUE, *supra, and the decision of this Court in* DOOLEY v. PEASE, *supra.* These two cases are further discussed below at pages 19-21.

(3) The Circuit Court of Appeals correctly held in effect that the loss in this case must be regarded as a loss "under either Subsections (f) or (k)" of Section 23 of the REVENUE ACT OF 1936 (26 U. S. C. A. 23). Petitioner is here con-

tending in the first instance that the loss was a bad debt loss under Subsection (k), and in the alternative, if it is not a bad debt loss under Subsection (k) then it is a loss under Subsection (f). Subsection (k), prior to the 1942 amendment, provided that "debts *ascertained* to be worthless" may be charged off in the taxable year in which they are so ascertained. *There is not a scintilla of evidence in this case that Petitioner ascertained prior to 1937 that the debt contingently owing to it by the indemnity fund was worthless.* In holding that Petitioner's loss was not deductible in 1937 under these circumstances, the Circuit Court of Appeals *virtually acknowledged in express language in its opinion* that it was rendering a decision on this aspect of the case in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in HARRIS v. COMMISSIONER, 140 F. (2d) 809, and in conflict with the decision of that Court in ROSENTHAL v. HELVERING, 124 F. (2d) 474. Petitioner submits the decision herein is in conflict with the decisions in both of these cases and in conflict with Subsection (k), Section 23, REVENUE ACT OF 1936. These cases are further discussed at pages 24-25.

(4) The decision of the Circuit Court of Appeals herein is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in RHODES v. COMMISSIONER OF INTERNAL REVENUE, 100 F. (2d) 966 (further discussed at page 33), *in that there is no evidence whatever in the present case that Petitioner was "clearly unreasonable and unfair" in arriving at its conclusion that the loss occurred in 1937*, whether the loss be deemed a bad debt loss under Subsection (k) or a loss under Subsection (f). On the contrary, the evidence establishes conclusively that Petitioner was perfectly fair and reasonable in reaching this conclusion. The Court in the RHODES case, supra, held that "common sense

interpretation is the safest rule to follow in the administration of income tax laws," and that even a loss under Subsection (f) must be allowed in the taxable year in which it is claimed *"unless it appears from the facts that the taxpayer was clearly unreasonable and unfair" in determining the year in which the loss occurred.*

(5) The Circuit Court of Appeals in the present case has not only decided an important question of Federal law in conflict with the decisions of this Honorable Court and of other Circuit Courts of Appeal, but has rendered a decision that is also against public policy. *The decision penalizes a taxpayer for deferring in good faith and for good cause a deduction for income tax purposes, and thereby encourages a public tendency, already too pronounced, to claim doubtful deductions.* These doubtful deductions will be claimed at the earliest possible date if the taxpayer has cause to fear he may be penalized for postponing them until the losses become more definitely established. The Circuit Court of Appeals for the Ninth Circuit said in DOUGLAS COUNTY LIGHT & WATER COMPANY v. COMMISSIONER OF INTERNAL REVENUE, 43 F. (2d) 904: "Claimed deductions for *doubtful debts or inchoate losses* are not to be encouraged * * *. *Owing to the tendency to lower the tax rate, postponement of such a claim works to the benefit rather than to the injury of the government.*" (Emphasis ours.)

Judgment was rendered in the instant case by the Circuit Court of Appeals on December 5, 1946 (R. p. 157), and this application is therefore filed within the time allowed for that purpose.

For the foregoing reasons, this Court has jurisdiction herein under Supreme Court Rule 38(5)(b).

Questions Presented

The two questions presented in this case are (1) whether the Circuit Court of Appeals had jurisdiction to reverse the fact finding of the District Court, supported by substantial evidence, that the loss in controversy was sustained and ascertained by Petitioner in 1937 and was therefore deductible in that year; and (2) if the Court had such jurisdiction, whether it erred in exercising it to reverse the finding, which was supported not only by substantial evidence but by the great weight of all the evidence.

Reasons Relied Upon for Allowance of the Writ

(1) It is uniformly held that the question as to the year in which a loss occurs and is deductible for income tax purposes is *purely a question of fact.* It is also uniformly held that a Circuit Court of Appeals *has no jurisdiction to reverse the fact finding of a District Court that is supported by any substantial evidence.* The record reflects not merely some substantial evidence but a great preponderance of evidence in support of the fact finding of the District Court that the loss was sustained and ascertained by Petitioner in 1937 and was deductible in that year. *The Circuit Court was therefore clearly without jurisdiction to reverse this finding.* That Court simply made the mistake of treating the finding as a conclusion of law that could be overruled if deemed erroneous on any ground. *The source and nature of the error appears quite clearly in the following language of the Circuit Court's opinion:* "He (the District Judge) based this finding upon his *conclusion of law* that * * * the loss did not occur until that year (1937)." (Emphasis ours.)

(2) Petitioner's subscription to the indemnity fund was a bad debt loss under Subsection (k) of Section 23 of the REVENUE ACT OF 1936.

Section 23 of the REVENUE ACT OF 1936 (26 U.S.C.A. 23) prior to its amendment in 1942 was in part as follows:

> "In computing net income there shall be allowed as deductions:
>
> "(f) Losses by corporations. Losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> "(k) Bad debts. Debts *ascertained* to be worthless and charged off within the taxable year."

There is no evidence whatever in the record that Petitioner ascertained the debt to be worthless prior to 1937.

The Circuit Court in effect correctly held the loss was either a bad debt loss under Subsection (k) or a loss under Subsection (f). The subscription created a debt. The very moment Petitioner paid its $150,000.00 subscription into the indemnity fund, *that fund* (as distinguished from its trustee, National Bank of Commerce) *became indebted to Petitioner*. The fund remained indebted to Petitioner to the extent that assets were realized from the liquidation with which to pay the indebtedness, as provided in the contract. This indebtedness continued, at least contingently, until the final report was rendered on November 8, 1937, and in the language of the District Court until Petitioner "expressly or impliedly approved what the agent or trustee had done" after satisfying itself that the trustee did not and could not realize any funds from the liquidation with which to repay the subscribers. It will be recalled that Petitioner's contract with the trustee or liquidator provided that "the amount of said indemnity fund remaining in your hands *shall be repaid* to the subscribers of said fund" (R. p. 33).

(3) If Petitioner's subscription to the indemnity fund was not a bad debt loss under Subsection (k), then it was a loss under Subsection (f) that was sustained in 1937 and

was therefore deductible in that year. The evidence is uncontradicted that the loss was not ascertained by Petitioner until 1937; and as will be shown, the great preponderance of the evidence will establish that it was also sustained in 1937, *as the District Court found and held.*

(4) Petitioner could not have been under a duty to inquire of the liquidator as to the status or progress of the liquidation to determine exactly when the loss became complete, as the Circuit Court erroneously held, *for Petitioner was granted no legal right under its contract with the liquidator to make such inquiry* (R. pp. 31-33.) *There can be no duty without the correlative legal right to perform the duty.* It is immaterial that the liquidator might have divulged such information through courtesy if requested; the fact of controlling importance is that Petitioner had no legal right to demand the information and the liquidator was under no legal duty to divulge it, even if demand had been made. The contract provided that a final settlement and report shall be made by the liquidator only *"when the liquidation is fully completed"* (R. p. 33). Only one of the other banks that subscribed to the indemnity fund sought information from the liquidator during the progress of the liquidation, and this bank was not acting "even informally * * * as a representative of other banks" (R. p. 91). It is apparent that the right of inquiry as to the progress of the liquidation was omitted in the subscribers' contracts for good and sufficient reasons, which are discussed in the brief (pp. 27-8). In any event, the right was not granted, *and information obtained from other sources would have been mere hearsay and unreliable.* Moreover, Petitioner had *"implicit confidence"* in the ability and integrity of the liquidator (R. p. 84). *Hence Petitioner had no right, duty or cause to inquire about the status and progress of the liquidation.*

(5) Even if Petitioner had learned through "rumor" that the liquidation was proceeding unsatisfactorily, if this were the case, and though Petitioner had confidence in the ability and integrity of the liquidator, *it was still Petitioner's duty to its stockholders to defer any action in the matter until it received and examined the final report of the liquidator, issued November 8, 1937, to determine whether the liquidation had been properly and fairly conducted.* The deduction of its subscription as a loss on mere suspicion or rumor, prior to receiving and examining the final report, *would have constituted an unwarranted, premature approval of the liquidation and determination of loss,* which the law neither requires nor permits. The District Court correctly held with reference to this final report that Petitioner "had the right to object to all or any part of it, to sue to set it aside, wholly or in part, and there could be no loss until taxpayer (Petitioner) expressly or impliedly approved what the agent or trustee (liquidator) had done" (R. p. 143).

(6) In concluding after it received and examined the final report of liquidator on November 8, 1937 that the loss occurred in that year, Petitioner was not "unreasonable and unfair," but on the contrary, the evidence is uncontradicted that Petitioner acted throughout in perfect good faith. And the deduction, even under Subsection (f), must be allowed *"unless it appears from the facts that the taxpayer was clearly unreasonable and unfair"* in his determination as to the year in which the loss occurred. RHODES v. COMMISSIONER OF INTERNAL REVENUE (6th Cir.), supra. Aside from the liquidation of the tangible assets of Public National, the receiver of that institution was recovering judgments against its stockholders and making payments of collections to the liquidator during 1933, 1934, 1935, 1936 and 1937. The receiver did not file his petition to wind up the affairs of Public National until August 12, 1937 (R. pp. 17-18). Moreover,

as above noted, the only report Petitioner received from the liquidator prior to receiving the final report in 1937 was the report it received October 26, 1932, consisting of a balance sheet of Public National showing its assets exceeded its liabilities by $764,907.05 (R. pp. 38, 82-3). The liquidator, testifying for Respondent, said he did not consider the liquidation "had been completed" until he made his final report on November 8, 1937 (R. p. 97). *This is but some of the evidence of Petitioner's good faith; other such evidence will appear in abundance.*

(7) The liquidation did not become a *"closed and completed transaction"* until 1937 for the reasons mentioned in Paragraph (6) above. JONES OIL COMPANY v. COMMISSIONER OF INTERNAL REVENUE (10th Cir.), 114 F. (2d) 642.

(8) The decision of the Circuit Court of Appeals herein is against public policy. It encourages a public tendency, already too pronounced, to claim doubtful deductions for losses. If a taxpayer has cause to fear that he may be penalized by disallowance of a loss that he defers in good faith until it is better established, *as was done in this case,* he will certainly deduct at the earliest possible date all losses that can reasonably be claimed. *This is not only contrary to public policy; it is contrary to the interests of the government.* For as stated in the DOUGLAS COUNTY LIGHT & WATER COMPANY case, supra, the postponement of a doubtful claim works to the benefit rather than to the injury of the government, *"owing to the tendency to lower the tax rate."*

WHEREFORE, your Petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that Court to certify and send to this Court a full

and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals had in the cause numbered and entitled on its docket, No. 11,566, FRANK SCOFIELD, COLLECTOR OF INTERNAL REVENUE, APPELLANT v. FIRST NATIONAL BANK IN HOUSTON, ET AL., APPELLEES, to the end that this cause may be reviewed and determined by this Court as provided by statute; and that the judgment herein of the Circuit Court of Appeals be reversed by this Court and the judgment of the District Court affirmed, and for such further relief as may be proper.

Dated February 20, 1947.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No._____

FIRST NATIONAL BANK IN HOUSTON, ET AL., *Petitioners*,

v.

FRANK SCOFIELD, COLLECTOR OF INTERNAL REVENUE, *Respondent*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions of Courts Below

The opinion of the District Court herein (R. pp. 137-144) is reported in 62 Fed. Supp. 297. The opinion of the Circuit Court of Appeals (R. pp. 151-6) is reported in 158 Fed. (2d) 268.

Jurisdiction

The jurisdiction of this Honorable Court is shown under the Jurisdictional Statement in the preceding petition (pp. 5-8), which is hereby adopted and made a part of this brief.

Statement of the Case

All of the facts pertinent to the points to be presented

have been stated in the preceding petition under the Summary Statement of the Matter Involved (pp. 1-5), which is likewise adopted and made a part hereof.

Specification of Errors

1. The Circuit Court of Appeals erred in holding the fact finding of the District Court that the loss was sustained and ascertained by Petitioner in 1937 was a "conclusion of law."

2. The Circuit Court erred jurisdictionally in reversing the fact finding of the District Court, supported by substantial evidence, that the loss was sustained and ascertained by Petitioner in 1937.

3. The Circuit Court erred in holding that Petitioner should have ascertained the loss prior to 1937.

4. The Circuit Court erred in holding the loss was sustained prior to 1937.

Statutes Involved

The statutes involved in this case are Subsections (f) and (k) of Section 23 of the REVENUE ACT OF 1936 (26 U.S. C.A. 23), which prior to the 1942 amendment were as follows:

> "In computing net income there shall be allowed as deductions:
>
> "(f) Losses by corporations. Losses sustained during the taxable year and not compensated for by insurance or otherwise.
>
> "(k) Bad debts. Debts ascertained to be worthless and charged off within the taxable year."

ARGUMENT

Points Presented

Point 1. **It is uniformly held (a) that the question**

as to the year in which a loss occurs and is deductible for income tax purposes is purely a question of fact, and (b) that a Circuit Court of Appeals has no jurisdiction to reverse a fact finding of a District Court that is supported by any substantial evidence. The finding of the District Court herein that the loss was sustained and ascertained in 1937 is supported not only by substantial evidence but by a great preponderance of all the evidence. The Circuit Court therefore had no jurisdiction to reverse the finding. (Germane to First and Second Specifications of Error.)

Point 2. **The loss was a bad debt loss under Subsection (k) of Section 23 of the Revenue Act of 1936, and Petitioner ascertained the debt was worthless in 1937.** (Germane to Third Specification of Error.)

Point 3. **If the loss was not a bad debt loss under Subsection (k), then it was a loss under Subsection (f) and it occurred in 1937.** (Germane to Fourth Specification of Error.)

Point 4. **Even if it should be considered that the loss was one under Subsection (f) that occurred prior to 1937, Petitioner was not "unreasonable and unfair" in its determination that the loss occurred in 1937; its good faith is unquestionable.** (Germane to Fourth Specification of Error.)

Point 5. **The Circuit Court's decision, in addition to being contrary to established principles of law, is against public policy.** (Germane to Third and Fourth Specifications of Error.)

Summary of the Argument

It is believed that the argument which follows has been adequately summarized in the statement of the foregoing Points and in the preceding petition under Reasons Relied on for Allowance of the Writ (pp. 9-14). Consequently, no further summary of the argument will be presented here.

Argument Under Point 1

Point 1 Restated. **It is uniformly held (a) that the question as to the year in which a loss occurs and is deductible for income tax purposes is purely a question of fact, and (b) that a Circuit Court of Appeals has no jurisdiction to reverse a fact finding of a District Court that is supported by any substantial evidence. The finding of the District Court herein that the loss was sustained and ascertained in 1937 is supported not only by substantial evidence but by a great preponderance of all the evidence. The Circuit Court therefore had no jurisdiction to reverse the finding.** (Germane to First and Second Specifications of Error.)

Question as to Year in Which Loss Occurs and is Deductible is Question of Fact

The Circuit Court of Appeals in its opinion herein stated: "He (the District Judge) based this finding upon his *conclusion of law* that * * * the loss did not occur until that year (1937)." (Emphasis ours.)

The Circuit Court not only referred to the determination of the District Court that the loss did not occur until 1937 as a conclusion of law; it treated the determination as a conclusion of law that the Court had jurisdiction to overrule on any ground it deemed sufficient. This is the source of one of the most important errors committed by the Circuit Court in this case. *The determination that the loss occurred in 1937*

is not a conclusion of law; it is purely a finding of fact. And as such, the Circuit Court *had no jurisdiction to reverse it, if it is supported by any substantial evidence.*

The *"sole question"* presented in JONES v. COMMISSIONER OF INTERNAL REVENUE (9th Cir.), 103 F. (2d) 681, was whether certain stock "became worthless during the calendar year 1933 resulting in an actual loss to Petitioners, capable of ascertainment in that year." The Board of Tax Appeals held the stock had not become worthless in 1933. In affirming the decision of the Board of Tax Appeals, the Circuit Court said (684-5):

> "The Supreme Court has said: 'The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test.' Lucas v. American Code Co., 280 U.S. 445, 449, 50 S. Ct. 202, 203, 74 L. Ed. 538, 67 A.L.R. 1010. See also Monmouth Plumbing Supply Co., Inc., v. United States, D.C. Fla., 4 F. Supp. 349, 350; Brown v. Commissioner, 6 Cir., 94 F. (2d) 101, 103.
>
> "Rhodes v. Commissioner, 6 Cir., 100 F. (2d) 966, 969, contains a good summary of the rule on this subject:
>
> * * *
>
> " '*The question whether property becomes worthless during a particular year is one of fact.* If substantial evidence is presented upon which the Board of Tax Appeals makes a factual determination, *the only question of law presented in the review is whether the Board's findings are supported by substantial evidence.*'
>
> * * *
>
> "No showing has been made sufficient to justify us in ignoring the presumption of correctness in the Commissioner's ruling, *or to hold there was an entire lack of substantial evidence to support the findings of the Board.*" (Emphasis ours.)

The JONES case, supra, has been cited under the Jurisdictional Statement in the preceding petition (p. 6) as in conflict with the instant case. The grounds of conflict are obvious. The JONES case and the cases cited therein are sufficient, without the citation of additional authorities, to show it has been uniformly held that the question as to the year in which the loss occurred is purely factual and not legal. No distinction has ever been made in this connection, and none can be made, between the factual determinations of the Board of Tax Appeals and those of a District Court.

The error of the Circuit Court in treating as a "conclusion of law" the fact finding of the District Court that Petitioner's loss was sustained in 1937 has resulted in the rendition of a grievously erroneous judgment. *And if the judgment is not reviewed and corrected by this Honorable Court, much confusion in the law governing this important question will inevitably result.*

Circuit Court of Appeals Had No Jurisdiction to Reverse Fact Finding That Loss Occurred in 1937

It has long been established that the findings of the District Court on questions of fact are conclusive and the Circuit Court of Appeals has no jurisdiction to reverse them if they are supported by *any substantial evidence*. The rule was thus stated by this Honorable Court in an early case, DOOLEY v. PEASE, 45 L. Ed. 457, 460:

> "Where a case is tried by the court, a jury having been waived, its findings upon questions of fact are conclusive in the courts of review, it matters not how convincing the argument that upon the evidence the findings should have been different. Stanley v. Albany County Supers., 121 U.S. 547, 30 L. Ed. 1002, 7 Sup. Ct. Rep. 1234.

> "*Errors alleged in the findings of the court are not subject to revision by the circuit court of appeals or by this court, if there was any evidence upon which such findings could be made.* Hathaway v. First Nat. Bank, 134 U.S. 498, 33 L. Ed. 1006, 10 Sup. Ct. Rep. 608; St. Louis v. Rutz, 138 U.S. 241, 34 L. Ed. 946, 11 Sup. Ct. Rep. 337; Runkle v. Burnham, 153 U.S. 225, 38 L. Ed. 697, 14 Sup. Ct. Rep. 837." (Emphasis ours.)

The same rule in a more recent case, SOUTHERN SURETY COMPANY v. UNITED STATES (8th Cir.), 23 F. (2d) 55, is stated thus:

> "When an action at law is tried without a jury by a federal court, and it makes a general or special finding of fact, *the act of Congress forbids a reversal by the appellate court of that finding, or of the judgment based thereon 'for any error in fact.'* Section 879, Title 28, U.S.C. (R.S., Sec. 1011; Act Feb. 18, 1875, c. 80, Sec. 1). And a finding of fact contrary to the weight of the evidence is an error of fact. Wear v. Imperial Window Glass Co. (C.C.A.), 224 F. 60, 63, and cases there cited." (Emphasis ours.)

As stated in the JONES case, supra, the sole question presented in such cases is *whether "there was an entire lack of substantial evidence to support the findings."* To the same effect are the decisions of this Honorable Court in the following tax cases: HELVERING v. RANKIN, 79 L. Ed. 1343; HELVERING v. NATIONAL GROCERY CO., 82 L. Ed. 1346, and WILMINGTON TRUST COMPANY v. HELVERING, 86 L. Ed. 1352.

The DOOLEY case, supra, was also cited under the Jurisdictional Statement in the preceding petition (p. 6) as in conflict with the present case. The conflict is obvious. However, the primary error of the Circuit Court of Appeals in the present case was in holding that the determination of the

District Court that the loss occurred in 1937 was a "conclusion of law." *That error led the Court into the further error of exercising a jurisdiction it did not possess, when it reversed this fact finding which is supported by substantial evidence.* Apparently no serious contention has been or will be made that the finding is not supported by *at least some substantial evidence.* Petitioner will show further under Points 3 and 4 that the finding is supported not only by substantial evidence but by a great preponderance of all the evidence.

Argument Under Point 2

Point 2 Restated: **The loss was a bad debt loss under Subsection (k) of Section 23 of the Revenue Act of 1936, and Petitioner ascertained the debt was worthless in 1937.** (Germane to Third Specification of Error.)

The Loss Was a Bad Debt Loss

The Circuit Court of Appeals correctly held in effect that the loss was either a bad debt loss under Subsection (k) or a loss under Subsection (f), Section 23, REVENUE ACT OF 1936 (R. p. 156). Petitioner submits that its subscription to the indemnity fund created a debt and the loss was therefore a bad debt loss. As stated in the preceding petition, the very moment Petitioner paid its $150,000.00 subscription into the indemnity fund, that fund (as distinguished from its trustee, National Bank of Commerce) became indebted to Petitioner. If for any reason, the original plan to liquidate Public National had been abandoned, it would have been necessary to repay the subscription to Petitioner at once. The fund remained indebted at least contingently to Petitioner until the final report was rendered on November 8, 1937, and in the language of the District Court until Petitioner "expressly or impliedly approved what the agent or trustee had

done," after satisfying itself that the trustee did not and could not realize any net assets from the liquidation with which to repay the subscribers. Petitioner's contract with the trustee or liquidator provided that "the amount of said indemnity fund remaining in your hands *shall be repaid* to the subscribers of said fund" (R. p. 33).

A subscription to a very similar indemnity fund, *created to aid a bank in distress,* was held to be *a debt* and the loss deductible as a bad debt in STEPHENSON v. COMMISSIONER OF INTERNAL REVENUE (8th Cir.), 43 F. (2d) 348. The Court in that case held as correctly in a syllabus:

> "Contribution by director to pool taking over questionable assets of bank under circumstances showing loss held 'charged off' within taxable year *and therefore deductible as worthless debt.*" (Emphasis ours.)

If A lends money to B with the understanding that it will be repaid *if and when* B obtains sufficient funds from a certain source, a debt is created. *The contingency can render the debt worthless but it cannot prevent the debt from arising.* That is the situation presented in the present case.

Petitioner Ascertained in 1937 That Debt Was Worthless

There is not a scintilla of evidence in the record that Petitioner ascertained prior to 1937 that the debt was worthless. The only information it received prior to 1937 was the interim report of the liquidator showing that Public National had net assets of more than $750,000.00 in excess of all liabilities, including those owing to the liquidator (R. pp. 38-9, 82-3). The evidence is uncontradicted that Petitioner first ascertained the debt was a loss when it received and examined the liquidator's final report on November 8, 1937.

Subsection (k), Section 23, REVENUE ACT OF 1936, prior to its amendment in 1942 was in part as follows: "Bad debts. Debts *ascertained* to be worthless and charged off within the taxable year." In 1942, Subsection (k) was amended to read: "Bad debts. Debts which become worthless within the taxable year." Under this subsection, prior to the amendment, it was immaterial when the debt actually became worthless; the controlling consideration was when the taxpayer "ascertained" the debt to be worthless.

The Circuit Court of Appeals for the Second Circuit has even held in HARRIS v. COMMISSIONER OF INTERNAL REVENUE, 140 F. (2d) 809, and has consistently held in other cases, that it is immaterial if the circumstances are such that the taxpayer should have ascertained the loss in a previous year, that the only inquiry which can properly be made under the statute prior to its amendment is whether he actually ascertained the loss in a previous year. ROSENTHAL v. HELVERING (2nd Cir.), 124 F. (2d) 474, is to the same effect. The Circuit Court of Appeals in the present case has in effect acknowledged that its decision on this point is in conflict with the decisions in these two cases, and Petitioner submits the decision herein is in conflict with those decisions.

In the HARRIS case, supra, the Court held (811):

> "At any rate we have deliberately held in this circuit that the so-called objective, or reasonable man, test of the ascertainment of worthlessness is not to be applied. A taxpayer is not bound to act, in ascertaining the value or the worthlessness of a debt due him, upon the basis of what a 'reasonable man' in his shoes might determine about it. In our view the 'subjective test' is the right one, and the proper year to make the charge-off is that in which the taxpayer actually makes the determination of worthlessness."

The conflict in these decisions is of such character that this

Honorable Court should review and correct the judgment in this case.

Even if it should be considered that the "reasonable man" rule should be applied in interpreting Subsection (k), notwithstanding the foregoing decisions to the contrary, it will be shown under Point 4 the evidence in this case is such that this rule can have no application here, for it cannot in any view be said that Petitioner should have ascertained the loss prior to 1937.

Argument Under Point 3

Point 3 Restated: **If the loss was not a bad debt loss under Subsection (k), then it was a loss under Subsection (f) and it occurred in 1937.** (Germane to Fourth Specification of Error.)

The Alternative Contention That the Loss Was One Under Subsection (f)

It is apparently conceded that if the loss was not a bad debt loss under Subsection (k), then it was a loss under Subsection (f). The Circuit Court of Appeals in effect correctly held it was one or the other (R. 156). Petitioner realizes these two subsections are mutually exclusive, that the same loss cannot properly be considered as a loss under both subsections. But there can be no objection to contending that a given loss was sustained under one of these subsections, and in the alternative, if it was not sustained under that subsection then it was sustained under the other.

Petitioner has contended in the first instance that its loss was a bad debt loss, *not because this was its principal contention* but because the bad debt classification is the more restricted of the two classifications. It appears more logical to say that if the loss is not in the smaller, more restricted classification, then it is in the larger classification.

Great Preponderance of Evidence Supports Finding of District Court That Loss Occurred in 1937

Some of the facts abundantly supporting the contention that the loss occurred in 1937 have been previously mentioned in support of other points. For convenience, these facts will be restated here, together with other pertinent facts.

Petitioner's contract with the liquidator did not contain any time limit for completing the liquidation (R. pp. 31-33). Only one report from the liquidator was received by Petitioner prior to receipt of the final report and that was a balance sheet of Public National dated October 26, 1932, showing that Public National had net assets of $764,907.05 in excess of all liabilities, *including its liabilities and obligations to liqudator* (R. pp. 39, 82-3).

At the instance of the liquidator, a receiver was appointed for Public National. Judgments against stockholders to enforce their statutory liability were being obtained and entered in 1933, 1934, 1935 and 1936. Collections were made by the receiver and paid over to the liquidator at intervals from 1933 to 1937, the last amount being paid on October 14, 1937. The receiver did not file his petition to wind up the affairs of Public National until August 12, 1937. The liquidator's final report of the liquidation was delivered to Petitioner November 8, 1937 (R. pp. 16-18). R. P. Doherty, Executive Vice-President of the liquidator, in testifying for Respondent, stated he did not consider the liquidation "had been completed" until November 8, 1937, when the final report was issued (R. p. 97).

Petitioner submits that the finding of the District Court that the loss occurred in 1937 is supported by the great weight of the evidence. It should be remembered in this connection *that it is necessary only to show the finding was supported by at least some substantial evidence.* For the finding is purely factual, and the Circuit Court was without juris-

diction to reverse it if it was supported by any substantial evidence, as shown under Point 1.

It would indeed be difficult to understand how an able, conscientious judge, who heard the evidence, could find the loss occurred in 1937 without the support of any evidence at all. The Circuit Court of Appeals apparently did not intend to hold this finding of the District Court was wholly unsupported. In its opinion, the Circuit Court erroneously considered the finding as a "conclusion of law" (R. p. 154), and then obviously decided it had jurisdiction to reverse the "conclusion" on any ground that was deemed proper, even though it was supported by substantial evidence.

Mr. Doherty's "Opinion Testimony" That Loss Occurred in 1933 Is Sharply Contradicted

The Circuit Court in reversing the factual determination of the District Court that the loss occurred in 1937, held the loss occurred in 1933. It rested this holding largely on Mr. Doherty's speculative testimony that in his opinion the loss occurred in 1933. *Respondent may attempt to say that Mr. Doherty's testimony was not contradicted.* Mr. Doherty's testimony that the loss was complete in 1933 *is contradicted by the balance sheet of October 26, 1932,* showing that the net assets of Public National in excess of all liabilities, including its liabilities to liquidator, was $764,907.05 (R. p. 38). The balance sheet of October 26, 1932 was prepared by the liquidator exactly one year after the liquidation began. The liquidator prepared this balance sheet not to deceive the subscribers to the indemnity fund but to correctly inform them as to the status of the liquidation and as to the amount of net assets in its possession at that time. *If Public National had any net assets at all in 1933, then Petitioner's subscription was not even a partial loss in that year.* The subscription did not become a complete, deductible loss until the net assets of

more than $750,000.00 were exhausted and a deficit of $1,-200,000.00 resulted, sufficient to consume all of the indemnity fund. For if any part of the indemnity fund remained after the liquidation was completed, it was to be refunded pro rata to the subscribers (R. p. 33). *It is difficult to understand how there could be a shrinkage of nearly $2,000,-000.00 in the assets of a bank that was not in operation but in liquidation within the few months that intervened between October 26, 1932 and 1933.* The impossibility of such a shrinkage is convincing evidence in contradiction of Mr. Doherty's "opinion testimony" that the loss occurred in 1933. *Certainly it is at least some evidence in opposition to this testimony and in support of the fact finding of the District Court that the loss did not occur in 1933.*

The balance sheet of October 26, 1932 was offered in evidence jointly by Petitioner and Respondent as a part of their Stipulation (R. pp. 15, 38). *There is no evidence whatever in the record that challenges the correctness of this balance sheet.* The mere fact that the assets were taken "at book value" cannot impugn the accuracy of their valuation. The Court will doubtless take judicial knowledge that it is customary to report the assets of a bank at book value, that the book value of an asset is frequently taken at "cost or market value whichever is lower" *and is therefore often below the actual value.*

Moreover, a condition once proved to exist is presumed in law to continue until the contrary is established. Hence when Petitioner established conclusively that Public National, in liquidation on October 26, 1932 had net assets, or a net worth, of more than $750,000.00, *it would require more than the mere opinion testimony of any witness to overcome the presumption* that at the end of a brief interval of only a few months at least some of these assets remained. And *it would require much more than that testimony* to establish that dur-

ing this brief period all of these net assets of this bank in liquidation had been consumed and a deficit of $1,200,000 had resulted.

Mr. Doherty's testimony that the loss was complete in 1933 is further contradicted by the evidence that the liquidation was then in full progress and that substantial collections were being made in that year. The sale of certain assets of Public National to the liquidator on May 20, 1933 was not conclusive on any question. If that sale were for an inadequate amount, it was the right and the duty of Petitioner and the other subscribers to sue to set it aside, when they learned the facts, as the District Court in effect held. The liquidator did not report this sale to Petitioner until 1937.

Liquidation Which Determined Loss Was Not "Closed and Completed Transaction" Until 1937

As noted above, collections were being made during each year from 1931 to 1937, inclusive, and Mr. Doherty testified he did not consider the liquidation "had been completed" until the final report was rendered November 8, 1937. A great many things could have happened prior to 1937, while the liquidation was still in progress, that would have prevented Petitioner's subscription from being a total loss. *If assets had been realized from unexpected sources it would have been the duty of the liquidator to account for them.* The liquidation certainly was not under these circumstances the "closed and completed transaction" contemplated by the Treasury regulations until the final report was rendered in 1937, *which was the "identifiable event" marking the conclusion of the liquidation and establishing the loss.*

TREASURY REGULATION 86, Art. 23(e) is as follows:

> "In general losses for which an amount may be deducted from gross income *must be evidenced by closed*

and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed." (Emphasis ours.)

The Circuit Court of Appeals for the Fourth Circuit in PRICE v. COMMISSIONER OF INTERNAL REVENUE, 106 F. (2d) 336, quoted the foregoing regulations and held as correctly stated in a syllabus:

> "Where taxpayer in 1931 executed and delivered note to bank under guaranty agreement and in 1932 executed note to bank in settlement of his liability, *loss was not sustained in 1931, since then it was not definitely ascertained that taxpayer would sustain a loss* or if so what it would be, nor was it sustained when taxpayer paid note, since that was but the payment of a debt incurred when loss was sustained, and payment of a debt results in no deductible loss but loss was sustained and was deductible in 1932, *since guaranty and payment thereunder were closed and completed transactions within treasury regulation.*" (Emphasis ours.)

In UNITED STATES v. WHITE DENTAL MANUFACTURING CO., 71 L. Ed. 1120, JUSTICE STONE said:

> "* * * Art. 141 of Treasury Regulation 45, provides that losses incurred in the taxpayer's trade or business or in any transaction entered into for profit may be deducted but such losses must usually be evidenced by closed and completed transactions."

If there should be any doubt as to the correct application of the Treasury regulation to the present case, the doubt should be resolved against the government. *Such regulations have always been "construed most strictly against the government."* In this connection, the Circuit Court of Ap-

peals for the Ninth Circuit in the DOUGLAS COUNTY LIGHT & WATER COMPANY case, supra, said (905):

> "A treasury regulation has the force and effect of law unless it is in conflict with an express statutory provision. Ardsley Club v. Durey (D.C.), 40 F. (2d) 293; Union Bed & Spring Company v. Springer (C.C.A.), 39 F. (2d) 383. And in case of doubt, statutes levying taxes are construed most strictly against the government. Gould v. Gould, 245 U.S. 151, 38 S. Ct. 53, 62 L. Ed. 211."

For all of the foregoing reasons, Petitioner submits that the District Court correctly found the loss was sustained in 1937; that this finding is abundantly supported by substantial evidence, and the Circuit Court was therefore without jurisdiction to reverse it. And even if the Circuit Court would have had jurisdiction to reverse the finding, that court still would have erred in reversing it because, as shown above, the finding is supported by the great weight and preponderance of the evidence.

Argument Under Point 4

Point 4 Restated: **Even if it should be considered that the loss was one under Subsection (f) that occurred prior to 1937, Petitioner was not "unreasonable and unfair" in its determination that the loss occurred in 1937; its good faith is unquestionable.** (Germane to Fourth Specification of Error.)

Many of the facts and circumstances showing conclusively that Petitioner was not "unreasonable and unfair" in its determination that the loss occurred in 1937 have been stated above. For convenience, some of these will be briefly restated here together with other pertinent facts. And as will be shown, it has been uniformly held that even though a loss

under Subsection (f) occurred in a year prior to its deduction, the deduction will be allowed unless the taxpayer was unreasonable and unfair in his determination that the loss occurred in the year it was deducted, and unless there was an identifiable event fixing the loss in a previous year *that was identifiable to the taxpayer.*

Petitioner made no inquiry of the liquidator or anyone else as to the status of the liquidation prior to receipt of the final report in 1937. Under the terms of its contract with the liquidator, Petitioner was granted no legal right to inquire. This contract provided for the issuance of a full report only "when the liquidation is fully completed" (R. p. 33). There can be no duty to inquire as the Circuit Court erroneously held, without the correlative right to perform the duty.

It is perfectly understandable that the contract did not grant the right of inquiry; the right was probably withheld for good reasons. The banking situation in Houston was critical at the time the contract was executed (R. p. 14). Undue inquiry and discussion about the progress of the liquidation could have disclosed information concerning the precarious financial situation of important business concerns in the city. Rumors emerging from such discussions could have reacted disastrously on the financial community. In any event, the right of inquiry was not granted in the contract, and information obtained by Petitioner from other sources would have been mere hearsay and unreliable. Obviously, Petitioner could not be required to obtain and act on information through "rumors, newspaper reports," or other equally unreliable sources, *as the District Court has correctly stated in its opinion* (R. p. 143). The only authentic source of information was the liquidator. It is immaterial that the liquidator through courtesy might have divulged information concerning the liquidation on request; the controlling

questions are whether the liquidator was under a legal duty to divulge such information on demand, and whether Petitioner had a legal right to demand it. The record supplies negative answers to these questions.

Only one of the fifteen subscribers to the indemnity fund inquired of the liquidator as to the progress of the liquidation (R. p. 90). The party who sought this information *was not acting "even informally * * * as a representative of other banks"* (R. p. 91). Some of the subscribers to the indemnity fund deducted their losses prior to 1937, but in this connection the District Court correctly held that they simply did *"some long range guessing"* (R. p. 144).

The contract with the liquidator contained no time limit for the completion of the liquidation (R. pp. 30-33). Petitioner had *"implicit confidence" in the liquidator* (R. p. 84). And when Petitioner received the report from the liquidator October 26, 1932 showing that Public National had net assets of more than $750,000.00 in excess of all liabilities, including those owing to the liquidator, Petitioner assumed and had a right to assume that the liquidation was proceeding with a reasonable degree of success. Not until it received the final report on November 8, 1937, did Petitioner learn that all of the net assets of Public National reflected in the 1932 statement had been consumed and that a loss would result.

It cannot be said under these circumstances that Petitioner was "unreasonable and unfair" in its determination that the loss occurred in 1937.

With reference to a loss resulting from the destruction of property by a hurricane, the Court in RHODES v. COMMISSIONER OF INTERNAL REVENUE (6th Cir.), 100 F. (2d) 966, stated in its opinion (969):

> *"Common sense interpretation is the safest rule to follow in the administration of income tax laws.* Gross

income and deductions flow from trade, commerce and dealings in property carried on in the ordinary business way and in the determination of taxes men should measure both by ordinary, everyday business standards. Compare Woolford Realty Co. v. Rose, Collector, 286 U.S. 319, 332, 52 S. Ct. 568, 76 L. Ed. 1128; United States v. Hardy, 4 Cir., 74 F. (2d) 841.

"In arriving at losses the taxpayer should determine in the first instance the tax year in which sustained and such deductions should be allowed by the Commissioner of Internal Revenue *unless it appears from the facts that the taxpayer was clearly unreasonable and unfair* at the time he was compelled to make his decision. Subsequent events may show a taxpayer to have been wrong but these must have been ascertainable by the exercise of ordinary business care and judgment at the time he made his income tax return." (Emphasis ours.)

The foregoing conclusions of the Sixth Circuit Court on this important question are salutary and sensible. They represent the clear weight of authority. If it should be considered that the loss in the present case occurred prior to 1937, which we deny, then the decision of the Fifth Circuit Court herein is in conflict with the decision of the Sixth Circuit Court in the RHODES case, supra. For, as stated, there is no evidence whatever in the record of this case that Petitioner was "unreasonable and unfair" in its determination that the loss occurred in 1937. On the contrary, Petitioner's good faith is perfectly evident and unquestionable.

The Circuit Court of Appeals seemed to be unduly concerned about Petitioner's action in charging "its contribution to the fund to profit and loss" in 1931 (R. p. 154). There was nothing unusual in this action. Any reasonable person would have known, and Petitioner knew, that its subscription or contribution to the indemnity fund was an asset that was at least doubtful. It is common practice among

banks, and is in accord with the "very strict rules as laid down by the Federal Reserve Bank," to charge doubtful assets to profit and loss (R. pp. 70, 83). If the item is later collected, it is credited to the profit and loss account. Items charged to the profit and loss account of a bank are not deducted as losses on an income tax return until it is proved that the item is worthless and not merely doubtful.

The Circuit Court of Appeals for the Fifth Circuit in FIRST NATIONAL BANK OF FORT WORTH v. COMMISSIONER OF INTERNAL REVENUE, 140 F. (2d) 938, was confronted with *the same identical question as to whether the action of a bank in charging an item to its profit and loss account was evidence that the bank considered the item worthless.* The Court in that case correctly held the profit and loss entry afforded no evidence that the bank considered the item was worthless, and in its opinion said (940):

> "We are of opinion the Tax Court erred when it found and held that the charge-offs ordered by the bank examiner were to be taken as ascertained and total loss when such orders were made. This is not correct. The bank examiner was calling upon the bank to bring its accounts within the very strict rules as laid down by the Federal Reserve Bank. It must not be taken that his orders to charge off spelled an ascertained final loss."

Obviously, the Circuit Court was of the opinion in the present case that if there were an event fixing the loss prior to 1937 that was identifiable to the liquidator, this was sufficient to support its judgment of reversal, *whether the event was identifiable to Petitioner or not.* Such an event, if it occurred, was peculiarly within the knowledge of the liquidator and no one else. There is no evidence in the record that any such events were identified by Petitioner and but little, if any, evidence that they were identifiable to Petitioner.

Various reasons have been discussed above as to why Petitioner did not consider it either necessary or advisable, even if it were possible, to inquire into the status of the liquidation or to search for an "identifiable event."

Before a taxpayer can be penalized for failure to claim his loss early enough, *the loss must have been fixed by "an identifiable event which has been brought to the taxpayer's knowledge."* It was so held in GOWEN v. COMMISSIONER OF INTERNAL REVENUE (6th Cir.), 65 F. (2d) 923, wherein the Court said (924):

> "It is also true that instances may arise in which the value of the shares held has 'become finally extinct' and in which the taxpayer is justified in claiming deduction; (citing cases) but we are of the opinion *that the taxpayer is not required to ascertain at his peril the year in which such value may become extinct,* provided the stock is still held and there may be some future value, *and provided further that there is an absence of an identifiable event which has been brought to the taxpayer's knowledge* and which clearly evidences the destruction, either then or theretofore, of value." (Emphasis ours.)

Moreover, it was Petitioner's duty to its stockholders to defer any action with reference to the liquidation until it received and examined the final report of the liquidator in 1937. It was its duty to determine whether the liquidation had been properly and fairly conducted before approving it. If Petitioner had deducted the loss and thereby concluded the matter prior to the receipt of the final report, such action would have constituted an unwarranted, premature approval of the liquidation and determination of loss, which the law neither requires nor approves.

Petitioner was not "unreasonable and unfair" in its deter-

mination that the loss occurred in 1937, but on the contrary it has acted throughout in perfect good faith. The loss was therefore deductible in 1937, as the District Court found and held.

Argument Under Point 5

Point 5 Restated: **The Circuit Court's decision, in addition to being contrary to established principles of law, is against public policy.** (Germane to Third and Fourth Specifications of Error.)

There is a public tendency, already too pronounced, to claim doubtful deductions for losses. The decision of the Circuit Court of Appeals herein will encourage this tendency and is therefore against public policy because it penalizes a taxpayer for deferring a loss deduction in good faith and for good cause until the loss is better established. If a taxpayer has cause to fear that he may be penalized by disallowance of a loss that he defers under such circumstances, he will certainly deduct at the earliest possible date all losses that can reasonably be claimed. To encourage such a tendency is not only contrary to public policy; it is contrary to the interests of the government because of the decreasing tax rates. As previously noted, in DOUGLAS COUNTY LIGHT & WATER CO. v. COMMISSIONER OF INTERNAL REVENUE (9th Cir.), 43 F. (2d) 904, the Court said in this connection (905):

> "*Claimed deductions for doubtful debts or inchoate losses are not to be encouraged,* and therefore the taxpayer ought not to be penalized for deferring his claim for deductions until he has in good faith resorted to reasonable measures for avoiding or minimizing a threatened loss. *Owing to the tendency to lower the tax rates, postponement of such a claim works to the benefit*

rather than to the injury of the government." (Emphasis ours.)

Conclusion

Petitioner submits that its petition for a writ of certiorari herein should be granted for the following reasons which have been presented in the foregoing brief:

(a) The Circuit Court of Appeals had no jurisdiction to reverse the fact finding of the District Court that the loss was sustained and ascertained by Petitioner in 1937. This finding was supported not only by the substantial evidence required to deprive the Circuit Court of jurisdiction to reverse it, but by a clear preponderance of all the evidence.

(b) The loss was a bad debt loss under Subsection (k) and Petitioner ascertained in 1937 that the debt was worthless.

(c) If the loss was not a bad debt loss under Subsection (k), then it was a loss under Subsection (f) and the loss occurred in 1937.

(d) Even if it should be considered that the loss was one under Subsection (f) that occurred prior to 1937, Petitioner was not "unreasonable and unfair" in its determination that the loss occurred in 1937. On the contrary, the evidence is uncontradicted that Petitioner acted throughout in a fair and reasonable manner and in absolute good faith.

(e) The liquidation of Public National Bank & Trust Company, out of which the loss arose, was not a "closed and completed transaction" until 1937.

(f) If the loss occurred prior to 1937, there was no identifiable event fixing the loss that was identifiable to Petitioner.

(g) The testimony on which the Circuit Court largely relied, offered by Respondent's witness R. P. Doherty, that

in his opinion the loss was complete in 1933 is sharply contradicted by the balance sheet showing that on October 26, 1932 Public National had net assets of more than $750,000.00 after deducting all of its indebtedness, including that owing to the liquidator. It is not readily understandable how the assets of a bank that was not in operation but in liquidation could have declined so alarmingly in value that these net assets of more than $750,000.00, and all of the indemnity fund of $1,200,000.00, were completely exhausted and consumed within the brief interval of time between October 26, 1932 and 1933.

(h) The Circuit Court was unduly influenced by the fact that certain other contributors to the indemnity fund deducted their losses prior to 1937. The District Court correctly held that these contributors simply did "some long range guessing."

(i) The Circuit Court was unduly influenced by the fact that Petitioner charged its contribution to the indemnity fund to its profit and loss account as a doubtful item. This was routine. It was done to satisfy the exacting requirements of the bank examiners with reference to all items that are doubtful, and cannot be considered as evidence that Petitioner considered the contribution was a loss at that time. The same Circuit Court so held in a similar case, FIRST NATIONAL BANK OF FORT WORTH v. COMMISSIONER, supra.

(j) It was Petitioner's duty to its stockholders to defer any action with reference to the liquidation until it received and examined the final report of the liquidator in 1937.

(k) The decision of the Circuit Court is against public policy. It penalizes a taxpayer for deferring a loss deduction in good faith and for good cause until the loss is better established. The decision thereby encourages a public tendency

to claim loss deductions at the earliest possible date even though they are doubtful.

Respectfully submitted,

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WILLARD L. RUSSELL,
Of Counsel

INDEX

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 1086

FIRST NATIONAL BANK IN HOUSTON, ET AL., PETITIONERS

v.

FRANK SCOFIELD, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 137–144) is reported at 62 F. Supp. 297. The opinion of the Circuit Court of Appeals (R. 151–156) is reported at 158 F. 2d 268.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 5, 1946. (R. 157.) Petition for a writ of certiorari was filed March 3, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer, in computing its taxable net income for the year 1937 is entitled, under Section 23 (f) or (k) of the Revenue Act of 1936, to a deduction of $150,000 by reason of its subscription in the year 1931 to a fund guaranteeing the National Bank of Commerce of Houston against loss as the liquidating agent of the Public National Bank and Trust Company of Houston.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *.

* * * * *

STATEMENT

The District Court adopted (R. 138) the stipulation of facts (R. 13–51) and supplemental stipulation of facts (R. 52–55) as a portion of its findings. These facts may be summarized as follows:

In 1931, the Public National Bank and Trust Company of Houston, hereinafter called "Public", was in financial difficulties and its closing by the banking authorities appeared likely. A number of other banks and business institutions including taxpayer,[1] fearing a general business crash would follow such closing, raised an indemnity fund of $1,200,000 to be paid to the National Bank of Commerce of Houston (hereinafter called liquidator), under agreement by which it would be the liquidating agent to take over Public, assume its liabilities and liquidate it. (R. 13–14.) The taxpayer paid $150,000 into the fund under an understanding with the liquidating agent that (a) if in liquidating "you sustain losses equal to or exceeding" the fund, "then the full amount of said fund shall belong to you"; (b) if no loss or a loss of less than the guaranty fund is sustained, a pro rata refund would be made to the subscribers; (c) final settlement with subscribers would be made when the liquidation was fully completed; provided, however, that pro rata refunds would be made from time to time as, and to the extent that, the indemnity fund was in excess of the liabilities assumed. Taxpayer's board of directors was told when it approved the $150,000 payment that the entire $1,200,000 guaranty fund would be absorbed

[1] The suit was brought by First National Bank of Houston and First National Bank in Houston, as its successor. The successorship is without bearing on the issues here and reference to both banks will be as the "taxpayer."

in meeting Public's obligations and they accordingly charged the payment to the profit and loss account, and it was charged off. (R. 14–15, 20–35.)

On December 13, 1932, at the instance of the liquidator, a receiver was appointed for Public with authority to wind up its business. On February 1, 1933, the United States Comptroller of the Currency assessed Public's stockholders for full payment of their liabilities totalling $800,000 on or before March 8, 1933. Of the total amount assessed only $146,308.34 was collected by the receiver and paid to the liquidator. (R. 15–16.)

On March 29, 1933, there was due and owing the liquidator $2,964,743.25, and in May, 1933, the receiver of Public, under court authority, for the sum of $1,150,000 sold all of Public's assets except stockholders' liability, to the liquidator, which credited Public's indebtedness with that sum, leaving due $1,814,743.25. (R. 16–17.)

On December 15, 1933, it having become manifest that only a small part of the stockholders' liability assessments would be collected and that the liquidator's losses would greatly exceed the indemnity fund, the liquidator appropriated the entire amount of the guaranty fund to its own use. (R. 17.)

In the year 1933 judgments totalling $72,479.68 against 16 different stockholders of Public in suits to enforce stockholders' statutory liability were obtained; in 1934 judgments totalling $277,337.13

against 29 stockholders; in 1935 judgments totalling $2,916.47 against four stockholders; and, in 1936 judgments totalling $11,378.41 against three stockholders. (R. 17–18.)

In 1934 the liquidator received from Public's receiver on account of stockholders' liabilities, $137,295, and in 1937, $9,012.74. (R. 16.)

On August 12, 1937, the receiver of Public on a petition showing, with respect to stockholders' liabilities, that $65,006.12 of the 1933 judgments, $276,687.13 of the 1934 judgments, and all of the 1935 and 1936 judgments remained uncollected and unsatisfied, obtained an order authorizing sale of all the uncollected judgments to the liquidator for $38,003.38. (R. 18.) On November 8, 1937, the liquidator prepared a final statement showing that it had sustained a loss of $373,278 over and above the guaranty, and sent a copy to taxpayer and others. (R. 18–19.)

On March 10, 1938, taxpayer filed its income tax return for the calendar year 1937, claiming as a loss deduction the $150,000 it had paid to the fund in 1931. (R. 19.) The Commissioner of Internal Revenue disallowed the deduction and assessed a deficiency. After payment, the claim for refund was denied by the Commissioner on February 9, 1944. (R. 19–20.)

In addition to finding the facts as stipulated, the District Court made only the following findings (R. 138–139):

(b) After October 26, 1932, and until Liquidating Agent made its report (November 8, 1937), Taxpayer had no information from Liquidating Agent respecting the liquidation of Public National.

(c) After receiving Liquidating Agent's Report (November 8, 1937), Taxpayer examined it, accepted it as correct, and thereafter had no further claim for a return of its $150,000, or any part thereof, and sustained a loss of the full amount thereof.

(d) Taxpayer sustained a loss during the year 1937 and after November 8, 1937, of such sum of $150,000, which was not compensated by insurance or otherwise.

The Circuit Court of Appeals reversed. (R. 156.)

ARGUMENT

1. The Circuit Court of Appeals held that the District Court's conclusion that the loss was sustained in 1937 "flies in the face of the undisputed facts that identifiable events, which made the loss certain, occurred many years before." (R. 156.) It accordingly reversed. The standard applied by the court below is that announced by this Court in *Boehm* v. *Commissioner,* 326 U. S. 287, where it was held that (p. 292) "a loss, to be deductible under § 23 (e), must have been sustained *in fact* during the taxable year." The District Court, however, obviously misapprehended the nature of the loss deduction. Every statement in its conclusions of law (R. 139–144) and find-

ings of fact (R. 138–139) other than that incorporating by reference the stipulation, establishes that the court believed that the loss occurred when the taxpayer was informed of the exhaustion of the guaranty fund by the final report of the liquidator. But the stipulated facts adopted as the findings of the District Court (R. 138) show without question that the loss "in fact" occurred at least several years before 1937. The District Court's decision is therefore patently erroneous under the *Boehm* decision.

The statement of the Court in the *Boehm* case that (p. 294)—

> The stipulation shows a succession of "identifiable events," occurring long before 1937, to justify the conclusion that the stock was worthless prior to the taxable year. The serious losses over a period of years, the receivership, the receivers' reports, the excess of liabilities over assets, the termination of operations and the bankruptcy sale of the assets of the principal subsidiary all lend credence to the Tax Court's judgment. * * *

coincidentally has practically equal application to the facts of this case. (R. 13–20.) Here, in addition, there were further identifiable events. For example, the unquestionably proper appropriation on December 15, 1933, of the guaranty fund to its own use by the liquidator (R. 17) established the loss in 1933, at the latest. After that date under the agreement between the tax-

payer and the liquidator (R. 31–33) there was no possibility that the taxpayer would recoup any part of its advance. Unlike the factual situation in *Boehm,* there is not even a scintilla of evidence to indicate that the loss may have in fact occurred in 1937.

In view of the circumstance that the evidence, largely stipulated and raising no question of the credibility of witnesses, is susceptible of only the conclusion that the loss occurred long before 1937, there is no conflict with the "substantial evidence" rule expressed in *Jones* v. *Commissioner,* 103 F. 2d 681 (C. C. A. 9th), and *Rhodes* v. *Commissioner,* 100 F. 2d 966 (C. C. A. 6th), as alleged in the Petition (pp. 6–7). But in any event, the *Jones* and *Rhodes* cases involved appeals from the Board of Tax Appeals where the scope of review of fact questions is more limited than appeals from the District Court. *Cf. Merrill* v. *Fahs,* 324 U. S. 308, 310. Findings of the District Court are final only if not "clearly erroneous." Rule 52 (a), Federal Rules of Civil Procedure.[2] The "clearly erroneous" test accords with the scope of review in modern equity prac-

[2] *Murray* v. *Noblesville Milling Co.*, 131 F. 2d 470 (C. C. A. 7th), certiorari denied, 318 U. S. 775; *Katz Underwear Co.* v. *United States*, 127 F. 2d 965, 966 (C. C. A. 3d), certiorari denied, 317 U. S. 655; *Equitable Life Assur. Soc.* v. *Irelan*, 123 F. 2d 462 (C. C. A. 9th); *State Farm Mut. Automobile Ins. Co.* v. *Bonacci*, 111 F. 2d 412, 415 (C. C. A. 8th); *United States* v. *Aluminum Co. of America*, 148 F. 2d 416 (C. C. A. 2d).

tice[3] which has been variously stated.[4] This Court in *District of Columbia* v. *Pace,* 320 U. S. 698, 701, approved the statement of Mr. Justice Brandeis in *Virginian Ry.* v. *United States,* 272 U. S. 658, 675, that "in equity, matters of facts as well as of law are reviewable * * *." The Court continued in its *Pace* decision that findings of fact of the trial court were presumptively correct but that this rule did not deny power to the Circuit Court of Appeals to review facts "but rather went to the weight to be accorded to the findings of a lower court and had special pertinence where credibility of witnesses was involved" (p. 702).

Dooley v. *Pease,* 180 U. S. 126, similarly has no application, contrary to the allegation in the Petition (p. 6), since it was decided long before this Court changed the scope of review of District Court findings of fact by ratification of the Federal Rules of Civil Procedure. In any event, since under either test of the scope of review of factual determinations the Circuit Court of Appeals was correct, there is no basis for certiorari on this issue.

2. Although the taxpayer's principal contention before both courts below was that it suffered a

[3] Notes to Federal Rules of Civil Procedure, Rule 52; Proceedings of the Institute on Federal Rules (Cleveland, Ohio, American Bar Association, 1938) 318; Proceedings of the Symposium at New York City (American Bar Association, 1938) 287; and cases cited in footnote 2.

[4] See note 3.

loss in 1937, here its emphasis is on the bad debt deduction provisions of Section 23 (k). It should be noted that the item was deducted in the return as a loss rather than as a bad debt (R. 43), and, although the claim for refund was somewhat vague, the amended complaint quite definitely sought relief only under the loss provision. (R. 7–9, 51, 63.) The District Court made neither findings of fact nor conclusion of law relating to the bad debt issue. The issue, therefore, was not properly raised. *Helvering* v. *Salvage,* 297 U. S. 106, 109. The Circuit Court of Appeals concluded that the issue had not been raised in the claim for refund but stated that in any event the contention would not aid the taxpayer since the debt was ascertained to be worthless before 1937.[5] Although there is dispute among the circuits as to whether a subjective (*Harris* v. *Commissioner,* 140 F. 2d 809 (C. C. A. 2d) or objective test of worthlessness of a debt should be applied[6] (*Avery* v. *Com-*

[5] The discussion dealing with when the loss occurred is equally applicable. If a subjective standard were applied it is significant that it was stipulated that the taxpayer's board of directors were informed on October 27, 1931, that the entire $1,200,000 guaranty fund would be "lost" in liquidating Public. (R. 34.)

[6] This controversy has been eliminated for years, beginning after 1942 by Section 124 of the Revenue Act of 1942, c. 169, 56 Stat. 798 (26 U. S. C. Supp. V, Sec. 23, changing the bad debt deduction provisions of Section 23 (k) of the Internal Revenue Code to accord with the loss provisions of Section 23 (e) and (f). *Cf. Boehm* v. *Commissioner, supra.*

missioner, 22 F. 2d 6 (C. C. A. 5th); *Reading Co.* v. *Commissioner,* 132 F. 2d 306 (C. C. A. 3d), certiorari denied, 318 U. S. 778), the question need not be decided here. Moreover, although we think it abundantly clear that if there were a debt, it was ascertained to be worthless before 1937 under the subjective test, Section 23 (k) is inapplicable because there never was a debt. The agreement between the taxpayer and the liquidator (R. 31–33) provided that taxpayer would be entitled to a pro rata repayment out of the guaranty fund only if the liquidator sustained a loss less than $1,200,000. Accordingly, since it was undisputed that the liquidator sustained a loss far in excess of $1,200,000 (R. 18) no obligation to repay taxpayer ever arose and hence there was no "debt" that could become worthless in any year. *McLeod* v. *Commissioner,* 19 B. T. A. 134, 139; *cf. Birdsboro Steel Foundry & Machine Co.* v. *United States,* 3 F. Supp. 640, 644 (C. Cls.). Finally, the District Court did not find that the debt was charged off in 1937, and the stipulated facts show that it was charged off in 1931 (R. 14–15, 34–35). There is, therefore, no basis for a bad debt deduction in 1937.[7]

[7] See Art 23 (k)–1 of Treasury Regulations 94 promulgated under the Revenue Act of 1936.

CONCLUSION

The case was correctly decided by the court below, and there is no conflict of decisions. The petition should be denied.

Respectfully submitted,

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